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Economic Outlook

Irving Trust

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Despite an accommodative stance by the Federal Reserve, the economy seemed to remain virtually dead in the water throughout much of this year. In August, however, the economy finally began to perk up. Although the improvement was partly due to special situations that will not persist, it appears that the economy is regaining forward momentum.

One particularly welcome development in August was the rise in manufacturing employment for the first time this year. The increase was probably overstated because of difficulties with the seasonal adjustment procedure when model changeovers in the auto industry differ from past patterns. Nevertheless, manufacturing employment excluding the auto industry rose in August after an extended series of declines.

On another favorable note, domestic auto sales totaled an extraordinary 9.7 million units at an annual rate in August. Including imports, sales were 12.6 million units at an annual rate, compared to 10.4 million in 1984, which was considered a good year for the auto industry. Since the surge in sales reflected below-market financing by the automakers, a sizable drop in sales of domestic cars is to be expected in October when the special incentives are no longer available. Nevertheless, the fundamental demand for autos remains relatively strong, particularly because of potential replacement demand. The average age of cars in use is still the highest since the early 1950s. Auto sales are now expected to total 11.1 million units this year and 10.3 in 1986.

Excluding autos, retail sales in August increased by a moderate 0.4% from the July level, not very impressive in view of the weakness evident in prior months. This type of mediocre performance highlights the dilemma that the Federal Reserve faces. By several measures, the Fed has pursued a relatively easy policy for much of this year. The decisive actions by the Fed have considerably reduced the possibility of a near-term recession. Yet despite several recent favorable economic reports, the recovery remains fragile, with numerous signs of hesitation and significant indications of financial stress still evident. As a result the Fed has been reluctant to do much about the excessive growth in M1 (the narrowly defined money supply) that has persisted throughout this year, particularly in view of the unusual declines in velocity (GNP divided by M1) so far this year.

Since the economy is only now beginning to respond to the past monetary stimulus, the Fed will likely try to strike a balance between reining in money growth and avoiding actions that might jeopardize improved economic growth. The result will probably be moderate increases in interest rates over the next six months or so.

Rapid money growth was also evident in 1983 and led to several well-publicized forecasts of accelerating inflation. (Money growth is admittedly higher this year than in 1983.) Nevertheless, consumer price inflation has remained remarkably stable; the increase in the consumer price index (on a December-to-December basis) was 3.9% in 1982, 3.8% in 1983, 4.0% in 1984, and will likely be about 3.9% this year also. With substantial excess productive capacity in the United States and abroad and with market pressures pointing to potentially weaker oil prices, it is likely that inflation will remain near 4% next year as well.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual		1985					Forecast 1986	Actual 1983- 1984	Forecast 1984- 1985	Forecast 1985- 1986
	I	II	III	IV	I	II	III	IV			
Gross National Product	5.6	4.7	7.9	8.4	7.5	8.3	6.1	7.4	10.8	6.5	7.5
Real GNP	0.3	2.0	4.1	4.8	4.0	3.8	1.5	2.6	6.8	2.7	3.6
GNP Price Deflator	5.4	2.7	3.7	3.5	3.4	4.3	4.5	4.7	3.8	3.7	3.8

	Actual 1985: II	Forecast 1985:III	Actual 1983-1984	Forecast 1984-1985	Forecast 1985-1986
Consumer Spending	8.6%	7.2%	8.6%	7.6%	8.0%
Durable Goods	6.3	6.5	13.9	7.6	6.6
Nondurable Goods	7.1	2.7	6.9	4.4	5.9
Services	10.3	10.6	8.5	9.9	9.8
Business Capital Spending	12.6	7.7	20.6	10.1	9.1
Structures	14.0	8.2	16.0	12.9	9.0
Equipment	11.8	7.5	23.4	8.6	9.2
Residential Investment	8.1	8.5	16.4	3.6	0.9
			1984	1985	1986
Change in Inventories	$18.1b.	$10.0b.	$58.2b.	$23.5b.	$35.5b.
Net Exports of Goods and Services	$-93.4b.	$-88.0b.	$-64.2b.	$-89.5b.	$-115.0b.
			1983-1984	1984-1985	1985-1986
Government Purchases	9.5%	11.1%	9.0%	9.7%	7.6%
Federal	5.0	15.0	9.5	11.5	5.6
Defense	12.0	8.8	10.5	9.5	7.0
Other	-12.5	35.0	6.7	17.6	1.8
State & Local	12.7	8.6	8.7	8.5	8.8
Corporate Profits Before Tax	-10.1*	2.1*	16.0	-3.1	8.1
Corporate Profits After Tax	-9.1*	-0.1*	14.5	-3.5	8.2
Plant and Equipment Expenditures	19.2	4.2	16.3	9.2	8.1
Real Final Sales#	4.7	5.0	5.0	3.6	3.3
Real Disposable Personal Income	8.1	-3.7	6.7	2.4	3.1

Economic Indicators	Recent Data June	July	Aug.	Actual 1983-1984	Forecast 1984-1985	1985-1986
Consumer Price Index**	2.4%	2.4%	2.4%	4.0%	3.9%	4.3%
Producer Price Index for Finished Goods**	-2.4	3.6	-3.6	1.7	1.3	3.4
Industrial Production	3.6	0.0	3.6	11.5	2.3	3.6
Retail Sales##	-1.0	0.2	1.9	10.5	5.5	6.3
				1984	1985	1986
Auto Sales (millions of units, a.r.)	10.3	10.3	12.6	10.4	11.1	10.3
Housing Starts (millions of units, a.r.)	1.69	1.65	n.a.	1.75	1.73	1.64
Unemployment Rate	7.3	7.3	7.0	7.5	7.3	6.9
Merchandise Trade Deficit (a.r.)	$161.0b.	$126.1b.	n.a.	$123.3b.	$150.0b.	$170.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
$b. = billions a.r. = annual rate F = Forecast

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